First National City Bank Monthly Letter

Business and Economic Conditions

1960

New York, August 1960

General Business Conditions

THE economic situation generally does not show much change during midsummer. This year is no exception. After allowance for vacations and other seasonal cutbacks, July brought no unusual changes in domestic business activity, despite rising international tensions and falling stock prices. The general trend of industrial activity is still indecisive although both output and demand remain at high levels. So far as can be ascertained from available data, industry's basic problem remains the same in midsummer as at the start of 1960: because current production rates are not fully supported by new orders, backlogs of unfilled orders are declining; because production is not being fully absorbed by the current rate of shipments, inventories continue to rise, although more slowly than in earlier months. Corporate profits have failed to keep pace with enlarged sales, reflecting a squeeze on profit margins in sharply competitive markets.

Estimates of gross national product for the second quarter testify to the strength of over-all demand, but, after adjustment for price changes, they also reveal that the total physical volume of goods and services barely increased over the first quarter. This is consistent with the sideways movement in industrial production and other physical measures.

In dollar totals, gross national product reached a new high in the June quarter at the seasonally adjusted annual rate of $505 billion. This was an increase of $3.7 billion over the first quarter, despite the sharp decline in the rate at which goods were being added to inventory. Businessmen cut their rate of inventory accumulation nearly in half, from $11.4 billion a year in the first quarter to $6 billion in the second. Such a reduction from the obviously excessive rate of accumulation in the first quarter is healthy for the economy. But with inventories piling up at a $6 billion annual rate, manufacturers and distributors have continued their efforts to curtail accumulation. As a consequence, it is likely that slackened inventory building will offset increases in other types of demand in the current period, just as they did in the second quarter.

Final demand—sales other than for inventories —rose more than $9 billion in the quarter, as consumers, businessmen, and government stepped up their purchases. About $5 billion of this increase was in consumer expenditures, which have been supported by record levels of employment and income. In fact, the rise of $7.3 billion in disposable personal income might have been expected to boost sales even more than it did. The remainder of the increase in gross product was spread among business investment in machinery and equipment, state and local government spending, and further improvement in exports. Residential construction, however, has not so far visibly responded to easier mortgage money and liberalizing steps by Government agencies.

Adjustment in Steel

The steel industry has borne the brunt of shifting inventory policy in recent months. Over-all

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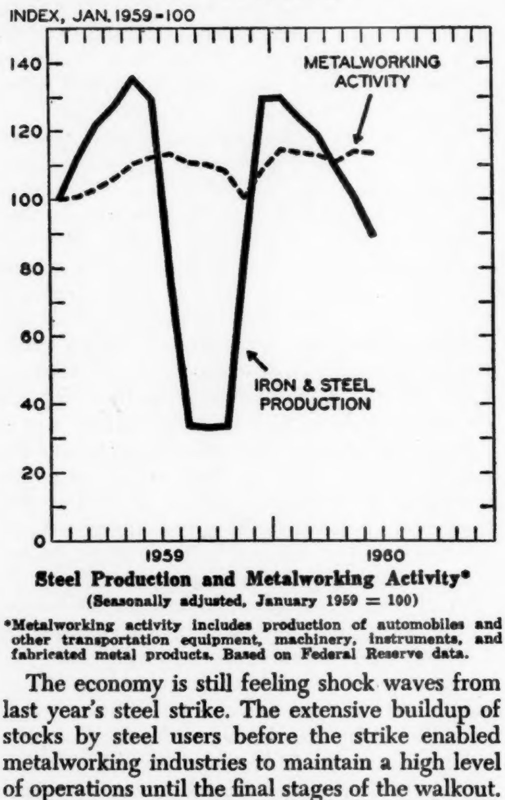
industrial activity, as measured by the Federal Reserve index (seasonally adjusted, 1957=100), edged down in June to 109.3, compared with 109.9 in May. This setback, however, was entirely accounted for by the 11 per cent drop in the iron and steel index; other industries as a whole held up. In fact, if the fluctuations in the iron and steel industry are removed from the production index, other output in May and June was at a new record, slightly higher than either the January peak or the prestrike level a year ago.

The wide swings in steel output are contrasted to the fairly stable pattern of steel demand — roughly represented by activity in metalworking industries — in the accompanying chart.



Steel Production and Metalworking Activity*

(Seasonally adjusted, January 1959 = 100)

*Metalworking activity includes production of automobiles and other transportation equipment, machinery, instruments, and fabricated metal products. Based on Federal Reserve data.

The economy is still feeling shock waves from last year's steel strike. The extensive buildup of stocks by steel users before the strike enabled metalworking industries to maintain a high level of operations until the final stages of the walkout. After the workers returned, steel mills rapidly pushed output well above current steel consumption levels in order to rebuild stocks. Before long, however, minimum working inventories were restored. Once prompt deliveries were available and it became clear that higher steel prices were not imminent, steel users began careful policing of their orders for steel to avoid an unnecessary and costly pile-up of excess stocks. As steel mills worked off backlogs of unfilled orders, production dropped below the rate at which steel was being chewed up by industry.

In July, output of steel dropped about one sixth from the already low June level — about the usual percentage decline for the vacation period. However, in the holiday week of July 4-10, mills were producing at only 42 per cent of capacity, the lowest operating rate since 1939 for any week not affected by a strike. Thus, in terms of unused capacity and in loss of tonnage compared with recent highs, the current adjustment in steel has already cut deeper than in any of the three postwar recessions. The remarkable thing is that this has happened when metalworking activity and production generally have remained close to record levels. The sheer magnitude of this "rolling readjustment" in steel has clouded the over-all industrial outlook; quite obviously, steel production has not been a good indicator of changes in manufacturing as a whole or even in metalworking industries.

Since the low in early July, steel mill operations have rebounded to 54 per cent of capacity. When a more pronounced upswing will appear depends on the inflow of new orders, which so far has not been great enough to lift order backlogs off rock bottom. Although some mills report scattered emergency orders from customers who let their steel stocks get too low, a general rise in orders for steel is not anticipated by the industry until late August.

Shrinking Backlogs and Swelling Stocks

Other durable goods industries, while maintaining output on a reasonably even keel, have, like the steel industry, seen their order backlogs contract. Production is not being fully absorbed, as shown by rising inventories at factories and in dealers' hands. This eventually will lead to a whittling down of production rates unless new orders start flowing in greater volume. The following table shows how changes in unfilled orders and inventories have been distributed.

Manufacturers' Inventories and Unfilled Orders

(Millions of dollars; *not* adjusted for seasonal variation)

Industry	Change from December 31, 1959 to May 31, 1960: Inventories	Unfilled orders
Iron and steel	+ 90	—2,320
Other primary metals	+ 140	— 170
Fabricated metals	+ 500	— 150
Electrical machinery	+ 400	— 110
Nonelectrical machinery	+ 470	+ 250
Transportation equipment (including motor vehicles)	+ 110	—1,090
Other durable goods	+ 310	+ 60
Durable goods total	+2,020	—3,530
Nondurable goods, total	+ 80	— 220
All manufacturing	+2,100	—3,750

Manufacturers' unfilled orders have declined steadily since their fourth quarter 1959 peak of

$51.5 billion, to $47.7 billion on May 31, the latest date for which figures are available. Although steel mills held only one tenth of all manufacturers' unfilled orders at the end of 1959, they have accounted for nearly two thirds of the total runoff of order backlogs. Another major decline in order backlogs was in transportation equipment other than automobiles, apparently because of reduced defense orders for aircraft and missiles. It is encouraging, however, to note the rise in unfilled orders for industrial machinery, which provides a base for continued heavy capital spending by business.

Two thirds of the rise in manufacturers' inventories occurred in metalworking industries, largely representing the replenishment of steel supplies. Also significant, although not covered by the table, has been the high level of dealers' stocks of new passenger cars. At midyear, as estimated by Ward's Automotive Reports, 1,060,000 new domestic cars and 150,000 imported cars were on hand. To clear these stocks, and to change over for an early introduction of 1961 models, the automobile companies are scheduling a sharp drop in production from 613,000 in June to 245,000 in August. By October output is scheduled to climb well beyond 600,000 cars, stimulating activity of steel mills and of a host of other suppliers.

First Half Corporate Earnings

While most measures of economic activity are clearly headed for new peaks in 1960, there remains some uncertainty as to whether business profits, after taxes, will make the grade. Corporate reports issued to date for the second quarter indicate that profits fell slightly short of the initial quarter, and lagged considerably behind second quarter 1959 when, prior to the steel strike, profits had touched a record level. Reports by 721 nonfinancial corporations show combined net income after taxes of $3.2 billion in the second quarter, 3 per cent below the March quarter and 12 per cent under the year-ago period. For the first half as a whole, profits of the reporting companies totaled $6.4 billion, falling short of the 1959 half by 4 per cent.

Among manufacturing firms alone, earnings of 533 companies amounted to $2.4 billion, a slippage of 5 per cent from the first quarter and 14 per cent from second quarter 1959. For the entire six months, combined earnings were 6 per cent short of their first half 1959 performance. A summary of earnings by industry groups is presented in the accompanying table.

Earnings in many industries have decreased even though the over-all economy has continued to expand. While failure to match the record of first half 1959 is partly attributable to the unusual stimulus given earnings by the pre-strike inventory buildup last year, many companies report that spotty price weakness, not always reflected in official indexes, is tending to erode earning power. More broadly, the markets are highly competitive, and managements have the challenging task of accomplishing savings to off-

NET INCOME OF LEADING CORPORATIONS FOR THE SECOND QUARTER AND FIRST HALF YEAR

(In Millions of Dollars*)

No. of Cos.	Industry Groups	Reported Net Income: Second Qr. 1959	First Qr. 1960	Second Qr. 1960	% Change from: Second Qr. 1959	First Qr. 1960	Reported Net Income First Half Year: 1959	1960	Per Cent Change
32	Food prod. & beverages	$ 90.0	$ 84.8	$ 86.7	— 4	+ 2	$ 176.0	$ 171.6	— 3
7	Tobacco products	61.1	54.5	62.5	+ 2	+15	112.2	117.0	+ 4
23	Textiles & apparel	17.0	12.6	11.7	—31	— 8	30.0	24.3	—19
7	Tires, rubber products	26.5	27.0	24.8	— 6	— 8	54.4	51.8	— 5
29	Paper & allied products	83.6	70.5	79.8	— 5	+13	150.7	150.3	—†
28	Chemical products	242.6	207.6	225.1	— 7	+ 8	442.3	432.7	— 2
26	Drugs, soap, cosmetics	59.7	63.6	57.4	— 4	—10	119.0	121.0	+ 2
30	Petroleum prod. and refining	551.4	626.0	572.0	+ 4	— 9	1,171.5	1,198.0	+ 2
43	Cement, glass, and stone	146.2	88.6	126.3	—14	+43	231.6	215.0	— 7
38	Iron and steel	418.9	310.4	189.9	—55	—39	704.3	500.3	—29
28	Electrical equip., radio & tv	109.1	103.3	101.7	— 7	— 2	204.8	205.0	+†
47	Machinery	110.5	88.8	99.4	—10	+12	180.9	188.2	+ 4
13	Nonferrous metals	84.7	55.5	67.8	—20	+22	153.6	123.4	—20
80	Other metal products	108.7	77.2	84.5	—22	+ 9	185.0	161.7	—13
36	Automobiles & parts	569.2	542.7	480.7	—16	—11	1,078.5	1,023.4	— 5
19	Other transp. equip.	28.5	23.7	31.2	+ 9	+31	55.0	55.0	—†
52	Misc. manufacturing	99.1	83.4	100.4	+ 1	+20	174.7	183.8	+ 5
533	Total manufacturing	2,806.7	2,520.3	2,401.9	—14	— 5	5,224.4	4,922.3	— 6
22	Mining & quarrying	38.6	30.8	38.4	—†	+25	70.7	69.3	— 2
33	Trade (retail and wholesale)	50.7	48.0	48.9	— 3	+ 2	100.0	96.9	— 3
24	Service & amusement	17.9	18.6	20.5	+14	+10	34.5	39.0	+13
50	Railroads	190.8	99.9	126.4	—34	+27	294.0	226.3	—23
54	Electric power, gas, etc.	170.8	236.7	190.5	+12	—20	398.7	427.2	+ 7
5	Telephone & telegraph	304.8	306.6	326.0	+ 7	+ 6	581.9	632.6	+ 9
721	Total	$3,580.3	$3,260.9	$3,152.6	—12	— 3	$6,704.4	$6,413.5	— 4

* Per cent changes and totals computed from unrounded data. † Increases or decreases of under 1% or over 100% not shown.

set pressures of rising employment costs and taxes. Thus, while a good many companies report record sales, a much smaller number are able to show new highs in earnings. For manufacturing firms reporting sales figures, our tabulation indicates that profit margins have narrowed from an average of 7.1 per cent of sales in first half 1959 to 6.6 per cent this year. Out of a total of 17 industry groups, 13 show thinner margins.

A Mixed Picture

Aside from strong competition, corporate managements this year have faced shifting patterns of consumer buying as well as changes in business policies with regard to inventories and capital investment. The sharpest adjustment was imposed upon the steel industry which saw its customers moving suddenly from a policy of inventory building to one of reduction. Thus, with operating rates falling sharply, the combined earnings of the iron and steel companies fell 29 per cent below first half 1959, when profits were swollen by the inventory rush. In the auto industry, the shift of consumer preference toward compact cars has affected earnings of individual companies. A similar diversity marked the performance of the electrical companies: despite improved sales of electronics products, television sets, and electrical equipment, weakening prices of appliances and changes in the defense program have hurt some producers.

The moderate growth in capital spending by business, and export orders generated out of the business boom in Europe and Japan, have brought a further recovery in earnings of a number of machinery makers. The decline in construction affected producers of lumber and plywood, plumbing equipment, cement, and other building supplies.

In the textile field, earnings of cotton goods manufacturers extended the more favorable trend evident in 1959. But producers of nylon, rayon, and some other man-made fibers report lower profits stemming from price reductions. In petroleum, some further recovery from the 1958 setback has been achieved in the first half.

Outside of manufacturing, the electric, gas, and telephone utilities continued their year-to-year growth. Amusement and service industries did conspicuously well. On the other hand, the railroads, while experiencing seasonal improvement over the first quarter, fell considerably short of results a year ago. In retail trade, profit margins tended to shrink with the result that net earnings slipped below 1959 in a number of cases despite growth in sales volumes.

Large Corporations and Economic Growth

"Economic growth" is the newest magic phrase on the lips of many a politician in this election year. But for the businessman, the idea of growth is old stuff.

In business life, the goal of growth is taken as a matter of course. Unless a businessman is prepared to take risks and expand, he soon finds himself pushed aside as more venturesome competitors take his place. Even after an enterprise reaches large size, the pressure to grow remains a vital force. Under the spur of competition, no one can afford to stand still. Business must constantly invest in new equipment and automation techniques to produce more efficiently the goods and services that people want. Large sums are spent for research to develop entirely new products and put them within reach of the public. In the process, more jobs are created and living standards raised.

In this way, the dynamic thrust of private business impels our whole economy forward toward greater productivity and a better life for all. Both directly and in roundabout ways, it creates the vast tax revenues needed to finance the manifold activities of government. It is ironic that the growth idea has lately been seized upon as a way of justifying schemes for even greater spending by government. After all, creating more and more goods and services for everyone – in other words, economic growth – is the business of the businessman.

The 100 Largest Manufacturers

Such an observation is amply supported by our recent economic history. We need only look at the record of major manufacturing corporations over the last decade to gain some idea of the pace-setting role of business enterprise in our economic progress. The following table lists the 100 largest manufacturers in terms of assets. This group of companies, of course, constitutes a blue-ribbon list of firms. Many smaller companies have performed more spectacularly in recent years, exploiting various phases of the new technologies. But the success of the large firms must be regarded as pretty good evidence of the important roles they have played in our economic expansion.

As was pointed out in this *Letter* last January, the United States enjoyed a period of vigorous expansion in the decade ended last year. Total output in dollars increased 87 per cent, from $258 billion in 1949 to $482 billion in 1959. Allowing for rising prices during the

period, the gain in physical output was about 46 per cent. Over the decade, our rate of real economic growth was a highly creditable 3.8 per cent a year.

Against this background, it is noteworthy that the total assets of the 100 largest manufacturing corporations reached $116 billion at the end of 1959 compared with $49 billion for a similar tabulation ten years earlier.* Total receipts from sales and other sources rose from about $60 billion for the firms on the 1949 list to $128 billion for the 100 largest companies last year. The figures for the two dates, of course, are not exactly comparable because of changes that have occurred in the list over the ten-year period. But even after allowing for these differences, it is apparent that as a group the 100 largest manufacturers have more than doubled their assets and sales during the decade.

*See "A $12,000 Investment per Job," in the June 1950 issue of this *Letter*.

Total Assets, 100 Largest Manufacturing Corporations, as Reported at the End of 1959

(In millions of dollars)

Allied Chemical Corp.	$ 785	Kennecott Copper Corp.	$ 803
Allis-Chalmers Mfg. Co.	528	Liggett & Myers Tobacco	404
Aluminum Co. of America	1,360	Lockheed Aircraft Corp.	521
American Can Co.	860	Minn. Mining & Mfg.	379
American Cyanamid Co.	630	Monsanto Chemical Co.	742
Amer. Rad. & Std. Sanitary	378	Natl. Dairy Prod. Corp.	642
Amer. Smelt. & Ref. Co.	444	Natl. Distillers & Chem.	509
American Tobacco Co.	807	National Lead Co.	381
Anaconda Co.	1,080	National Steel Corp.	863
Armco Steel Corp.	1,022	North American Aviation	381
Armour & Co.	398	Ohio Oil Co.	468
Atlantic Refining Co.	808	Olin Mathieson Chem. Cp.	839
Bendix Aviation Corp.	385	Owens-Illinois Glass Co.	492
Bethlehem Steel Corp.	2,269	Phelps Dodge Corp.	417
Boeing Airplane Co.	595	Phillips Petroleum Co.	1,580
Borg-Warner Corp.	445	Pittsburgh Plate Glass	619
Burlington Industries	526	Procter & Gamble Co.	860
Caterpillar Tractor Co.	536	Pure Oil Co.	554
Celanese Corp. of Amer.	397	Radio Corp. of America	811
Chrysler Corporation	1,375	Republic Steel Corp.	1,034
Cities Service Co.	1,298	Reynolds Metals Co.	955
Colgate-Palmolive Co.	378	R. J. Reynolds Tobacco	853
Continental Can Co.	751	Richfield Oil Corp.	433
Continental Oil Co.	788	St. Regis Paper Co.	455
Corn Products Co.	424	Schenley Industries	497
Crown Zellerbach Corp.	586	Shell Oil Co.	1,767
Deere & Co.	622	Sinclair Oil Corp.	1,494
Distillers Cp. - Seagrams	562	Singer Manufacturing Co.	523
Douglas Aircraft Co.	460	Skelly Oil Co.	394
Dow Chemical Co.	859	Socony Mobil Oil Co.	3,347
E. I. du Pont de Nemours	3,011	Sperry Rand Corp.	849
Eastman Kodak Co.	916	Standard Oil Co. of Calif.	2,578
Firestone Tire & Rubber	854	Standard Oil Co. (Ind.)	2,847
Ford Motor Co.	3,905	Standard Oil Co. (N. J.)	9,895
General Dynamics Corp.	861	Standard Oil Co. (Ohio)	409
General Electric Co.	2,561	Sun Oil Co.	743
General Foods Corp.	518	Sunray Mid-Cont. Oil Co.	582
General Motors Corp.	7,908	Swift & Co.	554
B. F. Goodrich Co.	559	Texaco Inc.	3,348
Goodyear Tire & Rubber	1,002	Tidewater Oil Co.	856
W. R. Grace & Co.	580	Union Carbide Corp.	1,682
Gulf Oil Corp.	3,576	Union Oil Co. of Calif.	707
Inland Steel Co.	826	United Aircraft Corp.	531
Int'l. Bus. Mach. Corp.	1,466	United Fruit Co.	385
Int'l. Harvester Co.	1,145	United States Rubber Co.	659
International Paper Co.	949	United States Steel Corp.	4,712
Int'l. Tel. & Tel. Corp.	932	Western Electric Co.	1,475
Jones & Laughlin Steel	829	Westinghouse Elec. Cp.	1,498
Kaiser Alum. & Chem. Cp.	786	Weyerhaeuser Co.	611
Kaiser Steel Corp.	475	Youngstown Sheet & Tube	716

As a measure of business growth, as well as of increased costs of plant and equipment, the number of manufacturers with assets beyond a billion dollars more than doubled between 1949 and 1959, from 12 to 27.

To become a member of the "Hundred Largest Club" in 1949, a corporation needed at least $141 million in assets; by 1959 the minimum had grown over two and a half times to $378 million. As a result, 15 firms slipped out of the list and were replaced by others. On the average the firms which dropped out expanded 52 per cent during the decade. But this still was not enough to keep pace with the leaders.

The leading firms have gained – and now maintain – their top positions by meeting the changing needs of our nation. Thus, six of the fifteen companies in the current group that were not on the list a decade ago are aircraft and missile companies whose growth was spurred by the country's needs for missiles and jet planes. Three makers of railway equipment, on the other hand, fell from the list during the period. A steel company in fast-growing California has joined the 100 largest group, but another steel firm in the East has dropped out. Of the other companies displaced, seven are producers of foods, beverages, or textiles for which demands are growing less rapidly than for other things.

$20,900 Invested per Worker

As the 100 largest firms have expanded, they have created more jobs: about five million men and women were on their payrolls last year compared with slightly over four million for the companies on the 1949 list. But even more striking has been the increase in investment per worker. The average amount of assets per worker grew from $12,200 in 1949 to $20,900 last year.

Much of this investment is embodied in modern plant and automated equipment that makes work easier and yet more efficient. Plant and equipment, usually valued at original cost less accumulated depreciation, almost doubled during the period from $5,400 per employe 10 years earlier to $10,100 in 1959. In 1959 alone, the 100 largest firms invested more than $8 billion in property, plant, and equipment.

Though needs for capital are growing rapidly in practically all lines, some industrial operations require more than others. Topping the list are petroleum, distilling, and tobacco – each with an average of more than $50,000 per employe. Oil company assets include the value of huge reserves of crude oil and natural gas as well as expensive refinery plants and stocks

of refined products. Distillers must keep large stocks for aging in bonded warehouses, while tobacco companies have stores of leaf tobacco for curing and blending.

Average Total Assets per Employe, by Industry, of the 100 Largest Manufacturing Corporations in 1959

Number of Companies	Industry	Average Investment per Employe
21	Petroleum products	$62,000
3	Distilling	53,400
3	Tobacco products	50,700
8	Nonferrous metals	28,200
8	Chemical products	24,700
9	Iron and steel	21,200
3	Pulp and paper	18,800
3	Autos and trucks	14,800
11	Machinery and equipment	13,000
6	Food products	10,500
4	Tires, rubber products	10,300
5	Electrical equipment	10,100
7	Aircraft	7,600
9	Other manufacturing	17,700
100		$20,900

Assets per employe have more than doubled during the past decade for companies in the steel, automobile, and petroleum industries. The increases were nearly as great in nonferrous metals, distilling, and tires and rubber. On the other hand, assets per employe in the aircraft industry remained low, reflecting the large amount of machinery, plant, and other assets furnished by the Government for military work.

The worker himself has been a major beneficiary. Automation and mechanization have lessened the number of dirty, physically exhausting jobs. At the same time, payroll statistics published by companies with about 86 per cent of all workers employed by the 100 largest manufacturers show that the average annual compensation of workers climbed to more than $6,400 last year. A decade earlier, the figure was $3,500.

Along with the growth in capital investment, the number of shareholders has also increased rapidly. Ten years ago, the 100 largest corporations had slightly more than 5 million registered shareholders; the current group has almost 9 million. This figure, of course, overstates the total of individual shareholders to the extent that investors have shares in more than one of the companies on the list. On the other hand, many registered shareholders are trustees or "nominees" who hold shares for a number of individual owners. And considering the spectacular growth of mutual funds, pension funds, and similar institutions over the last decade, it can be said that millions of others have an indirect interest in these companies. The importance of the shareholders is illustrated by the fact that they provide about two thirds of the total capital invested in the 100 largest firms; various forms of debt account for the remainder.

Smaller Profit Margins

Although rising sales totals attest to their success in serving the public, even the biggest corporations have no guarantee that their earnings will rise correspondingly. Data on sales and income of the 100 largest manufacturers show that the companies are generating more and more income for others, but are able to keep only a small and shrinking share for dividends and reinvestment. In 1959 these companies had total receipts of $127.6 billion, but were able to bring down to net income only 6.4 cents out of every dollar of revenue. This represents a shrinkage of nearly one fifth in profit margin since 1949 when the 100 largest manufacturers earned 7.9 cents on every dollar of sales. The record is all the more striking since 1949 had been a year of business recession.

It is interesting to compare the disposition of receipts by the 100 companies on our current list with that of the large firms reporting such data in 1949. As the table shows, more than 93 cents out of every 1959 sales dollar was paid out to others for materials, wages, taxes, and interest or charged against depreciation of machinery and plant. Three of these large companies, in fact, lost money after making all the necessary charges and payments to their suppliers, workers, and government.

Disposition of Receipts by the 100 Largest U.S. Manufacturing Corporations in 1949 and 1959

	1959 Total (Millions)	1959 % of Receipts	1949 % of Receipts*
Total receipts from sales, revenues, etc.	$127,606	100.0	100.0
Costs:			
Costs of goods and services purchased from others, etc.	66,678	52.3	59.0
Wages, salaries, and labor benefits†	35,054	27.5	23.1
Provision for depreciation and depletion	6,247	4.9	3.6
Income taxes	6,316	4.9	4.2
Other federal, state, local & foreign taxes‡	5,100	4.0	2.2
Total costs of operations	$119,395	93.6	92.1
Net income	8,211	6.4	7.9
Preferred and common dividends paid	4,689	3.7	3.9
Retained in the business	3,522	2.7	4.0

*The 1949 breakdown of receipts covered only 97 of the 100 largest manufacturing corporations, since at that time Ford, Singer, and United Fruit did not publish detailed sales and income information.

†Estimated on basis of payrolls reported by companies representing 86 per cent of the total employment of the group.

‡Tax figures charged as costs include excise taxes for distilling and tobacco companies but generally not for other industries.

A little more than half of total receipts in 1959 was paid out to suppliers of goods and services needed by these manufacturers. About $35 billion was disbursed in wages and salaries, fringe benefits, and other employment costs, while over $11 billion was paid or accrued for various federal, state, local, and foreign taxes.

The relative share paid out for goods and services from other suppliers has fallen over the decade from 59 cents of each sales dollar in 1949 to 52 cents for the 100 firms last year. Payroll costs, however, took a substantially bigger slice last year — 27.5 cents of the sales dollar compared to 23.1 cents ten years earlier. Charges for depreciation and depletion were also bigger, reflecting the tremendous volume of new investment over the decade.

Growth In Taxes

A conspicuous contrast to the relative decline in net profits or income over the last 10 years is the precipitous rise in the share paid over in taxes to government. For the 100 largest manufacturers, total tax payments rose from 6.4 cents of each sales dollar in 1949 to 8.8 cents per dollar last year. Government's share, in other words, rose almost 40 per cent while, as noted earlier, the average profit margin was shrinking by nearly one fifth. It is a remarkable fact that in 1959 the companies paid 39 per cent more in taxes than they earned for themselves and their shareholders.

Part of the increase in taxes is accounted for by the Federal Government's corporate income tax, which stood at 38 per cent in 1949 but was boosted to 52 per cent during the Korean War and has stayed at that level ever since. The current rate, of course, has the effect of making the Federal Government the "majority shareholder" in every successful corporation. But taxes imposed by the various states and municipalities — and foreign governments in the case of firms operating overseas — have grown too. Such levies took only 2.2 cents per sales dollar in 1949, but absorbed 4.0 cents per dollar of revenue last year.

The owners of the 100 largest firms — the shareholders — get "paid" only after all other expenses are met. Last year, the dividends received by these owners came to 3.7 cents out of every sales dollar, compared with 3.9 cents ten years earlier. And even this shrunken share was maintained by slashing the relative amount retained in these businesses from 4 cents per dollar in 1949 to only 2.7 cents last year.

It will be no easy achievement in the next 10 years to match the gains of the past decade unless there is recognition by government, unions, and the community generally of the importance of adequate profits to further growth. After all, it is by developing profits, paying a fair return to shareholders, and reinvesting retained earnings that business attracts and builds the capital investment essential to meet the needs of an expanding economy.

Economic Stabilization in Latin America

Our neighbors south of the Rio Grande have, understandably, been most anxious to speed up the development of their economies in order to meet the demands of their growing populations for better living standards. To do this, of course, requires investment capital. For many years, there was a strong temptation in these countries to provide the needed funds by expanding credit, but this merely led to inflationary spiraling of prices and balance-of-payments difficulties.

As time passed, many Latin American countries came to realize that no economic advance can be sustained without a ready flow of genuine savings, from domestic sources as well as from abroad. To secure such savings, reasonable monetary stability must be restored and effectively maintained. Economic stabilization has thus come to be regarded as an economic necessity; and, as a South American saying puts it, "what is necessary must be made possible."

Stabilization Programs

Stabilization programs have been adopted during recent years in twelve Latin American countries. They vary according to the circumstances of each country but, fundamentally, they all aim at arresting inflation by eliminating, or substantially reducing, its principal source — borrowing from the central bank to finance government deficits. Another common ingredient of these programs is restraint of commercial bank credit. By arresting inflation, and thus halting excessive imports and the flight of capital, these countries have endeavored to reduce balance-of-payments deficits to amounts that can be financed by inflows of long-term capital.

To tide them over the initial period of stabilization, the Latin American governments and central banks have sought to borrow from the International Monetary Fund. They have presented the main lines of their programs to the Fund in declarations of intent that have formed an essential part of the credit arrangements they have negotiated. This is, it may be noted, a standard procedure for the Fund; the governments of the United Kingdom, France, and many other countries have also made commitments of this sort before drawing on the Fund.

As a rule, assistance granted by the Fund has been combined with credits from such other sources as the U. S. Treasury, the Export-Import Bank, the Development Loan Fund, and American—and recently also European — commercial banks. Such "packages" are tailored to the par-

Stabilization Credit Lines in Selected Countries
(In millions of dollars)

Country	Date	I.M.F.	U.S. Govt.	Com'l. Banks U.S.	Com'l. Banks Europe
Argentina	Dec. '58	$ 75.0	$199.5	$ 54.0	—
	Dec. '59	100.0	50.0	75.0	$75.0
Chile	Apr. '56	35.0	10.0	30.0	—
	Apr. '57	10.0	10.0	30.0	—
	Apr. '58	10.0	35.0	15.0	—
	Apr. '59	8.1	66.5	55.0	—
Colombia	June '57	25.0	—	—	—
	June '58	15.0	78.0	25.0	—
	Oct. '59	41.25	25.0	25.75	—
Guatemala	June '60	15.0	—	—	—
Mexico	Mar. '59	90.0 e.	175.0	—	—
Peru	Feb. '54	12.5	12.5	5.0	—
	Feb. '58	25.0	57.5	17.5	—
	Mar. '59	13.0	17.5	17.5	—
	Mar. '60	27.5	—	—	—
Venezuela	Apr. '60	100.0*	—	200.0†	—

Note: This tabulation includes stabilization credit lines, exclusive of other types of borrowing, made available at dates shown. Bolivia, Dominican Republic, Haiti, Honduras, and Paraguay have also received stabilization credits during 1956-1960.

*$15 million available before the increase in quota to $150 million becomes effective.

†Including one Canadian participant.

e.—Expired after six months.

Source: International Monetary Fund, Export-Import Bank, and newspaper reports.

ticular need of each country. The credits extended by the Fund, the U.S. Treasury, and the commercial banks are generally short- and intermediate-term (repayable within three to five years) while funds obtained from other sources are more likely to be long-term.

Breaking "Vicious Circles"

Inflation has been a serious problem for a number of Latin American countries at one time or another during the postwar period. They tried for years to alleviate it by controlling prices, imports, and exchange rates but, eventually, having experienced heavy drains on their reserves, they found it impossible to redress their position merely by intensifying bureaucratic controls. On the contrary, they wanted to extricate themselves from the complex array of direct controls and to attack inflation at its very roots by halting resort to the printing press. They returned, therefore, to orthodox monetary and financial policies, reestablished free exchange markets, and adopted realistic exchange rates, leaving market forces to bring about necessary adjustments in the economy.

The actual circumstances in which the "vicious circle" of inflation was broken were, of course, different in each country. The first Latin American nation to embark upon a stabilization program was Peru in 1954. It succeeded in achieving a better balance, internally as well as externally, but in 1957 experienced an inflationary relapse. A new effort to combat inflation was made in 1958 but as recently as July 1959 Peru still seemed inextricably enmeshed in the familiar tangle of a large budgetary deficit, rising living costs, and a balance-of-payments crisis.

At that point, President Prado of Peru called in as his Premier and Minister of Finance Sr. Pedro G. Beltran, an ardent advocate of economic freedom and orthodox finance. To stem the inflationary tide, Sr. Beltran has reduced the budgetary deficit and put a halt to government borrowing from the central bank. To finance the deficit, the Treasury is issuing 6- and 9-month Treasury bills – tax-free and bearing 10 per cent interest – underwritten by banks but sold to the general public. Wages and salaries, adjusted to compensate for cost-of-living increases up to the time when the stabilization program was implemented, were frozen for a year. When the freeze expired at the end of June 1960, the government declared that it would not decree across-the-board wage increases, but would encourage direct wage negotiations between employers and labor.

The results are gratifying. The cost of living, which had risen by 16 per cent during the first nine months of last year, rose by merely 1.2 per cent during the subsequent nine months ended June 1960. Gold and dollar reserves have risen despite the sizable repayments Peru has made on its short-term indebtedness abroad. Peru, which dismantled its direct exchange and import restrictions as early as 1949 but maintained a dual exchange rate, unified its exchange system in May 1960 – another notable achievement.

Gold and Foreign Exchange Reserves of Selected Countries
(In millions of dollars)

	Dec. 1957	Dec. 1958	Dec. 1959	June 1960
Argentina*	$ 162	$ 98	$276	$409†
Chile	46	59	130	128
Colombia	145	160	212	206‡
Peru	34	31	52	47¶
Mexico	453	372	413	423¶
Venezuela	1,446	1,050	693§	n.a.

Note: Gross reserves as reported by central banks.

*Gold and convertible foreign exchange only. †April. ‡May. ¶March. §November. n.a.—Not available.

Source: International Monetary Fund.

Chile adopted various stabilization measures in 1956, but after decades of inflation these efforts failed to restore a sustainable balance. At the close of 1958, when Chile's monetary reserves were practically exhausted, the Alessandri Administration decided to deal with the hard core of Chile's inflation – the government deficit. The deficit was largely a result of the country's system of automatic wage and salary increases for employes of government and government-owned enterprises, and of the failure of revenues to keep pace with currency depreciation. Reliance on central bank credit was curtailed; the government raised taxes and borrowed abroad to finance desirable public works.

Prices this year have been virtually stable — a remarkable accomplishment in view of the fact that as recently as January-September 1959 they had risen by 34 per cent. Foreign exchange reserves have increased markedly, in part, of course, because of favorable conditions in the world copper market; Chilean copper production was stepped up last year by 16 per cent.

Unfortunately, at the very moment when the economic stabilization was beginning to bear fruit, large parts of Chile were devastated by a series of earthquakes and tidal waves. This is a most severe blow. The Government has prepared a program for rebuilding the devastated areas and is presently increasing taxation to help pay the costs. However, it is expected that a large share of this program may be financed by external loans.

Colombia, in spite of lower prices for coffee which accounts for 80 per cent of its exports, has greatly strengthened its international position and, above all, its credit standing. Since 1958, the Lleras Government has pursued, with little relaxation, stern fiscal and monetary policies. Among other things, no central bank funds have been used to finance the harvest or stockpiling of coffee; stockpiling has been financed by proceeds derived from differentials between buying and selling rates of exchange. Not only has reasonable price stability been restored, but Colombia has also been able to repay most of the $500 million of the short-term external debt accumulated as a result of heavy over-importing during the previous administration. Repayments made in 1958 and 1959 equaled approximately one fourth of the country's foreign exchange income (excluding the proceeds of new borrowings) during those years; these repayments would not have been possible, however, had Colombia not maintained severe import controls.

"Austerity" in Argentina

Argentina's stabilization program was adopted in December 1958. It seeks to undo the legacy of an economic regime that squandered the nation's foreign reserves and left its economy greatly weakened, while creating — through unrealistic pricing and wage fixing — the illusion that it was possible for the people to consume more than they produce.

By boldly challenging the habits of years, the Frondizi Administration is endeavoring to adjust Argentina to economic reality. Its courageous "austerity" program has freed the economy — by, among other things, abolishing import licenses, creating a single free exchange market, and substantially raising the prices of products and services of state-owned enterprises. The losses incurred by state enterprises were the main reason for the government's over-all budgetary deficit, which had been financed by borrowing from the Central Bank of Argentina.

Taxation was also increased but care was taken to provide incentives to productive private enterprise; earlier this year, for instance, the tax on capital gains was reduced from 20 to 5 per cent and the minimum amount of capital gains left free of taxation was raised. On the other hand, budgetary expenditures were cut by reducing the number of government employees, abolishing price subsidies, and deferring public works. Commercial bank credit was restricted, and the Central Bank's provision of mortgage credit was discontinued.

As the economy was freed and the hidden inflation of the past came into the open, prices necessarily rose. The cost of living, which had increased by 50 per cent in 1958, doubled during 1959. An obvious peril to stabilization was, therefore, the pressure for wages to keep up with the rise in the cost of living; to counter this, the government set an example by granting to its employes wage adjustments smaller than the cost-of-living increase without, however, interfering with the bargaining of private employers and labor groups. This year, the rise in the cost of living has slowed remarkably — to 1.2 per cent a month during January-May.

Understandably, there are still many difficulties to be overcome. Although the over-all budgetary gap has been reduced, it is still regarded as too large to be financed by sound methods. Currently, it is being covered largely by external loans.

The foreign trade balance has improved markedly. Last year, Argentina had a small surplus — the first since 1954. Imports fell drastically and exports increased slightly; while exports of meat declined, this was offset by an increase in exports of wool and grains. Looking ahead, the availability of meat for export should be improved by the more realistic meat prices which now prevail in Argentina; rebuilding the herds is expected to expand meat production and domestic meat consumption has declined from extraordinarily high to more normal levels.

With some repatriation of Argentine funds, stabilization aid, and sizable inflows of capital from the United States as well as from Europe, gold and foreign exchange reserves have increased substantially. This has permitted a reduction in the high import surcharges that had replaced the import licensing system which was abolished at the end of 1958 — yet another step

in the direction set forth in Argentina's stabilization program.

Stabilization in Countries with Convertible Currencies

The countries of the northern part of Latin America — Mexico and the Central American republics — have maintained better financial stability than most of their sister nations to the south; furthermore, they have convertible currencies. Stabilization problems in these countries, therefore, have been quite different from those of their southern neighbors.

Mexico has had a stable exchange rate since the devaluation in 1954. Early last year, to strengthen the country's position and especially to maintain confidence in the peso in the face of some speculative pressure, the Mexican Government introduced a series of new budgetary and credit measures. To support this program, the International Monetary Fund and the Export-Import Bank extended credits to Mexico and the U.S. Treasury renewed an earlier stabilization agreement. Soon after the program was announced, capital began to return to Mexico. Stabilization efforts were so successful that it was unnecessary to extend the Fund credit beyond the initial period of six months.

At one time or another during the past two years, several nations — Honduras and Guatemala in Central America and the Dominican Republic and Haiti in the Antilles — have run into difficulties brought on partly by natural disasters but partly also by somewhat over-ambitious development schemes. Such schemes were encouraged by high export earnings, but when these fell off, exchange reserves were depleted so rapidly that corrective policies became necessary. Government budgets were balanced and commercial bank credit was restricted.

Venezuela, which also has a convertible currency, has had large reserves for many years. By the end of 1959, however, the high level of government outlays — partly to reduce the floating debt incurred in earlier years — led to a rapid loss of reserves; another reason for the drain on reserves was a weakening of confidence in future convertibility of the bolivar. This factor also tended to deter foreign investment capital. In April 1960, a program was enacted to limit government expenditures to a level that could be financed by ordinary revenues and long-term credits from abroad.

Results of Economic Stabilization

The results of economic stabilization, both psychological and tangible, have been highly encouraging. The improved stability of domestic prices and exchange rates, as well as the rise in gold and foreign exchange reserves, are all the more notable since they have occurred at a time when world demand for the raw materials produced by Latin America has, except for copper and a few other metals, brought little relief in the form of higher export earnings.

Economic stabilization after years of inflation is, of course, a painful process; when aggravated by disruptive strikes, as in Argentina last year, output may actually decline. But once inflation has been checked and there is a prospect of reasonable financial order, output increases rapidly. In Chile, where the economy had stagnated during decades of inflation, agricultural and industrial production has recently been increasing steadily. Colombia and Peru have also increased output since stabilization. Countries like Mexico and Ecuador, which have succeeded in maintaining internal as well as external balance within the framework of a free economy, have an excellent record of economic growth. It is, of course, the rise in domestic output that makes lasting increase in the standard of living possible.

With the re-establishment of realistic pricing and free exchange in Argentina, agricultural production — after two decades of neglect — has begun to recover. A realistic approach to the petroleum development problem is another bright spot. Last year, Argentina gave up its government oil monopoly, which after half a century was able to supply only one third of the country's needs, and invited foreign oil companies to help develop and expand the fields. As a result, crude oil production in 1959 was 30 per cent higher than in the previous year and Argentina expects to become self-supporting in oil by 1961.

Reasonable financial stability is needed to attract foreign capital; otherwise, there is always doubt about remitting profits. But foreign capital also needs equality of treatment with domestic capital. This is what Argentina offered in a new law promulgated early in 1959; Chile last April broadened the foreign capital investment law passed in 1954. The response by foreign investors has been favorable.

Problems, of course, remain. One of them is the pressure to relax as soon as monetary stability is in sight. Yet, looking backward at their stabilization experience, our Latin neighbors may well feel encouraged. They have shown to the world at large that they possess the resolution and fortitude required to achieve a substantial measure of balanced economic growth in a climate of economic freedom.

Prime Loan Rates in the World Today

The accompanying table, which brings up to date a similar compilation published in the July 1957 issue of this *Letter*, shows commercial bank prime loan rates in 59 countries. These are the lowest rates at which business firms of the highest credit standing can borrow from banks on an unsecured basis. Major business firms occasionally may be able to borrow at lower interest costs where an open market in "commercial paper" exists, but the volume of funds available in these markets is limited and such borrowings lack the flexibility of bank loans.

PRIME LOAN RATES

	Rate	
Major Money Markets	**June 1957**	**July 1960**
Japan	9%	9%
Germany	9	8-8½
France	7	7¼
Italy	7½	6½-7½
United Kingdom	5¼-5½	6½
Sweden	6½-7	6-6½
Canada	5½	5¾
Belgium	5-5½	5¼-6¾
United States	4	5
Netherlands	5½	4½-5½
Switzerland	4½	4½-5
Other Europe		
Greece	12	9-10
Austria	9½	8½
Denmark	7-8	7½
Turkey	7-9	7
Spain	6-6½	6½-7
Ireland	6¼	6½
Finland	8-8½	6-7
Norway	4¾	5½
Portugal	5-5½	4
Other British Commonwealth		
Bahamas	n.a.	6½
Jamaica	n.a.	6½
New Zealand	5	6
Pakistan	n.a.	6
Singapore	6-7	6
Malaya	n.a.	6
Hong Kong	5½-6	6
South Africa	6	6
Ceylon	n.a.	6
India	5½-6½	5½
Australia	5½	5½
Latin America		
Chile	12-14	15
Peru	11	13-13½
Brazil	12	12
Paraguay	n.a.	12
Argentina	8	10
Ecuador	10	10
Mexico	9½	10
Uruguay	8	9½
Colombia	6	8
Costa Rica	7	8
Honduras	7	7
Venezuela	6	7
Cuba	5	6-8
El Salvador	6	6-7
Guatemala	6	6
Nicaragua	7	6
Panama	5	6
Puerto Rico	4¼	5½
All Others		
Iran	7½-8½	12-15
Israel	11	10
Thailand	n.a.	9-12
Philippines	5-7	7½
Iraq	6-7	7-8
United Arab Republic: Syria	7-8	7
Vietnam	n.a.	6-7
Liberia	6	6
Jordan	n.a.	6
United Arab Republic: Egypt	5½-6	5½
Lebanon	7	4½-5

n.a. — Not available.

Note: Compiled by the Economics Department of the First National City Bank of New York from information available in New York in July 1960.

It must be borne in mind that money is frequently scarce at the banks' minimum rates. Most borrowers able to obtain funds must pay higher rates. In many countries, there are commissions and other arrangements which increase the cost of borrowing. The effective interest costs thus are generally higher than the rates shown in the table; for a number of countries the posted rates are, in fact, nominal.

Prime loan rates of 5 per cent, as in the United States, prevail in very few other countries. Rates of 6 to 8 per cent are quite frequent even in countries with developed money markets. Since last June, the prime rate has been at 6½ per cent in the United Kingdom, following the increase in the official discount rate from 5 to 6 per cent.

Here, a less restrictive Federal Reserve policy, evidenced in a half-point discount rate cut in June, created some stir of expectation that the 5 per cent commercial bank prime loan rate (in effect since September 1, 1959) might be cut. However, bank resources, curtailed by deposit contraction, remained too scarce to justify general loan rate reductions.

Interest rates today seem high when contrasted with the extremes of the past three decades of cheap money. But the artificially low rates were made possible only by a continuous creation of money, which in turn brought about price and cost inflation, economic distortions, and waste, as well as seemingly unmanageable balance-of-payments strains. In the past fifteen years, nation after nation has accepted the idea that there is no inherent virtue in cheap money and that interest rates should be flexible so as to bring the demand for loanable funds into a sustainable balance with supply.

Free dynamic economies continuously require vast amounts of capital, which in turn depend upon adequate savings. The price of capital — the rate of interest — therefore has an essential function to perform in a free society.

The interest rate is neither the hero nor the villain. It is the end-result of manifold influences permeating our entire economic life. The cost of borrowing can be reduced, without injurious effects on the economy, only if the nation's monetary and fiscal affairs are handled responsibly.

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